

REPORT OF EXAMINATION
OF THE
SAFEHEALTH LIFE INSURANCE COMPANY

AS OF
DECEMBER 31, 2006

Participating State
and Zone:

California

Filed November 30, 2007

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Los Angeles, California
September 28, 2007

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Kent Michie
Secretary, Zone IV-Western
Commissioner of Insurance
Department of Insurance, State of Utah
Salt Lake City, Utah

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary and Commissioner:

Pursuant to your instructions, an examination was made of the

SAFEHEALTH LIFE INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 95 Enterprise, Suite 100, Aliso Viejo, California 92656.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2002. This examination covers the period from January 1, 2003 through December 31, 2006. The examination was made pursuant to the National Association of Insurance Commissioners' (NAIC) plan of examination. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of December 31, 2006, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; business in force by states; mortality and loss experience; and sales and advertising.

SUBSEQUENT EVENTS

As of June 30, 2007, the Company reported surplus of \$19.9 million. During June 2007 the Company received a payment of \$1.9 million from its parent, SafeGuard Health Enterprises, Inc. (Enterprises), reducing the nonadmitted intercompany receivable by this amount, and thereby increasing its surplus.

On August 6, 2007, Enterprises announced the execution of a definitive agreement whereby MetLife, Inc. (MetLife), through one of its subsidiaries, will acquire Enterprises. The transaction has been approved by the Boards of Directors of MetLife and Enterprises. The transaction is expected to close by the end of 2007, subject to regulatory approval.

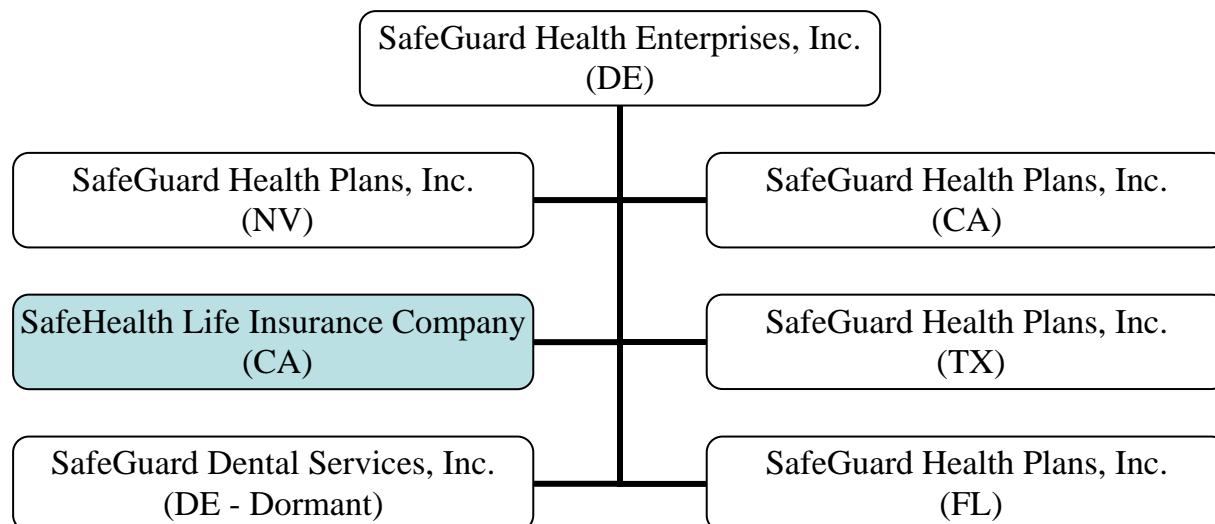
On August 17, 2007, the Company submitted a filing to the California Department of Insurance (CDI) pursuant to California Insurance Code (CIC) Section 1215.5(g) requesting approval to pay an extraordinary cash dividend of \$2.99 million to its parent, Enterprises. The filing was approved by the CDI on September 20, 2007 and paid on September 21, 2007.

COMPANY HISTORY

In June 2005, SafeGuard Health Enterprises, Inc., the parent company made a capital contribution of \$1.6 million to the Company in the form of cash.

MANAGEMENT AND CONTROL

The following organizational chart depicts the Company's relationship within the holding company system:



Management of the Company is vested in a four-member board of directors elected annually. A listing of the members of the board and principal officers serving on December 31, 2006 follows:

Directors

Name and Residence

Principal Business Affiliation

Stephen J. Baker
Cheyenne, Wyoming

President and Chief Operating Officer
SafeGuard Health Enterprises, Inc.

Ronald I. Brendzel
Laguna Hills, California

Senior Vice President, Secretary and General
Counsel
SafeGuard Health Enterprises, Inc.

James E. Buncher
Frisco, Texas

Chairman and Chief Executive Officer
SafeGuard Health Enterprises, Inc.

Dennis L. Gates
Orange, California

Senior Vice President and Chief Financial
Officer
SafeGuard Health Enterprises, Inc.

Principal Officers

<u>Name</u>	<u>Title</u>
James E. Buncher	Chief Executive Officer
Stephen J. Baker	President and Chief Operating Officer
Ronald I. Brendzel	Senior Vice President, Secretary and General Counsel
Dennis L. Gates	Senior Vice President and Chief Financial Officer
Robin Muck	Vice President
Joe J. Wild, III	Vice President
Raul Marcano	Vice President

Management Agreements

Administrative Services Agreement: On January 1, 2003, the Company entered into an Administrative Services Agreement with its parent, SafeGuard Health Enterprises, Inc. (Enterprises). Enterprises provides all non-employee administrative services that support all the business activities of the Company and its affiliates. Specifically, the services include, but are not limited to, consulting, legal, advertising, printing, and paying and maintaining office space and equipment. The Company reimburses Enterprises for the cost of these services through expense allocations based on actual cost incurred by Enterprises. For the year 2006, the Company paid Enterprises \$1,783,534 for the services provided under the terms of this agreement. This agreement was approved by the California Department of Insurance (CDI) on January 27, 2004.

Administrative Services Agreement: On January 1, 2003, the Company entered into an Administrative Services Agreement with its affiliate, SafeGuard Health Plans, Inc., a California corporation (CA Plan). The CA Plan agrees to make its executive officers, other management employees, and non-management employees available to manage and conduct all aspects of the business operations of the Company and its affiliates. The services include, but are not limited to, marketing, accounting and financial reporting, pricing and underwriting, legal representation, regulatory compliance, human resources, facilities management, sales and account management, provider network maintenance, quality management, provider reimbursement, client and broker

services, billing and collections, file maintenance, member services, and information services. The Company reimburses the CA Plan for the cost of these services through expense allocations based on actual cost incurred by the CA Plan. For the year 2006, the Company paid the CA Plan \$3,079,893 for the services provided under the terms of this agreement. This agreement was approved by the CDI on January 27, 2004.

Administrative Services Agreement with its affiliate, SafeGuard Health Plans, Inc., a Texas corporation (TX Plan). The TX Plan agrees to make its management and non-management employees available to manage and conduct all aspects of the business operations of the Company. The services include, but are not limited to, sales and account management, provider network maintenance, and quality management. The Company reimburses the TX Plan for the cost of these services through expense allocations based on actual cost incurred by the TX Plan. For the year 2006, the Company paid the TX Plan \$825,137 for the services provided under the terms of this agreement. It is recommended the Company submit the agreement to the CDI for approval pursuant to California Insurance Code (CIC) Section 1215.5(b)(4).

Administrative Services Agreement with its affiliate, SafeGuard Health Plans, Inc., a Florida corporation (FL Plan). The FL Plan agrees to make its management and non-management employees available to manage and conduct all aspects of the business operations of the Company. The services include, but are not limited to, sales and account management, provider network maintenance, and quality management. The Company reimburses the FL Plan for the cost of these services through expense allocations based on actual cost incurred by the FL Plan. For the year 2006, the Company paid the FL Plan \$267,842 for the services provided under the terms of this agreement. It is recommended the Company submit the agreement to the CDI for approval pursuant to CIC Section 1215.5(b)(4).

Tax Sharing Agreement: The Company files a consolidated federal income tax return with its parent, Enterprises, and various affiliates. The agreement is administered by Enterprises and allocation of taxes is based upon separate tax return calculations with all settlement of inter-company tax balances made within 10 days of the end of each quarter. The CDI approved this agreement on March 23, 2004.

Affiliated Transactions

The Company has a history of maintaining high intercompany receivable balances which are non-admitted. As of December 31, 2006, the nonadmitted receivable balance of \$2.7 million represents cash advances or transfers from the Company to its parent, Enterprises, which were transacted without any notice or approval by the CDI pursuant to CIC Section 1215.5(b)(1)(B). As such, the CDI assessed late filing fees pursuant to CIC Section 924 and directed the Company to settle the receivable balance. The Company settled the receivable balance in June 2007 and paid the late filing fees in July 2007.

CORPORATE RECORDS

California Insurance Code (CIC) Section 735 states that the Company must inform the board members of the receipt of the examination report. The board should be informed of the report both in the form first formally prepared by the examiners and in the form as finally settled and officially filed by the commissioner. The board must also enter that fact in the board minutes. A review of the board minutes disclosed that neither the officially filed report nor the first formally prepared draft by the examiners was presented to the board. It is recommended that the Company implement procedures to ensure future compliance with CIC Sections 735.

A review of the Company's board minutes disclosed that there was no authorization and approval of investments as required by CIC Sections 1200 and 1201. The Company's minutes failed to provide any general statements pertaining to its investments, which is in violation of CIC Section 1200. In addition, specific references to amounts, facts, and the value of the securities were not included as required under CIC Section 1201. It is recommended that the Company implement procedures to ensure that the authorization and approval of investments is documented in its board minutes to comply with CIC Sections 1200 and 1201.

TERRITORY AND PLAN OF OPERATION

As of December 31, 2006, the Company was licensed to transact life and accident and health insurance in the following 20 states:

Arizona	Kansas	Ohio
California	Kentucky	Oregon
Colorado	Maryland	South Carolina
Delaware	Missouri	Texas
Florida	Nevada	Utah
Georgia	New Mexico	Wisconsin
Illinois	Pennsylvania	

The Company primarily offers managed indemnity and PPO dental and vision products. Its main markets are small and mid-sized employer organizations, governmental entities, multiple employer trusts and to a lesser extent, large corporate employers. The Company's business is produced through a network of approximately 1,282 producers and 54 general agents.

In 2006, the Company wrote \$75 million of direct premiums. Of the direct premiums written, 56.5% or \$42.4 million was written in California, 31.2% or \$23.4 million was written in Texas, 6.2% or \$4.7 million was written in Florida, and 6.1% or \$4.5 million was written in the remaining states.

GROWTH OF COMPANY

The Company has experienced significant growth since the last examination as noted in the following schedule:

Year	Admitted Assets	Capital and Surplus	Direct Premiums Written
2002	\$ 10,195,395	\$ 6,650,345	\$ 32,801,497
2003	\$ 16,510,508	\$ 8,105,370	\$ 39,095,921
2004	\$ 25,507,286	\$ 12,323,148	\$ 60,107,151
2005	\$ 24,788,718	\$ 16,205,960	\$ 68,081,539
2006	\$ 22,987,212	\$ 15,302,919	\$ 75,022,577
2007 (*)	\$ 27,044,402	\$ 19,935,634	\$ 41,404,567

(*) Through 6/30/07

The significant growth is primarily the result of: (1) the Company's acquisition of Health Net's dental and vision insurance business in October 2003 which accounted for the most significant growth, (2) the Company started writing business in Nevada in 2005, (3) the Company started writing business in Arizona in 2006, (4) the Company's increased writings in California, Florida and Texas as the result of broad-based new sales and improvements in customer retention, and (5) a \$1.6 million capital contribution from its parent received in 2005.

REINSURANCE

Assumed

The Company is a party to a Stop Loss Reinsurance Agreement and an Insolvency Reinsurance Agreement with its affiliate, SafeGuard Health Plans, Inc., a Nevada corporation (NV Plan). Under the terms of the Stop Loss Reinsurance Agreement, the NV Plan pays a premium of 0.50% of its gross premium and the Company reimburses the NV Plan for all claims in excess of its revenue. The Insolvency Reinsurance Agreement requires the NV Plan to pay a premium of 0.25% of its gross premium and the Company to cover all claims in the event of an insolvency of the NV Plan. During

the exam period, the Company assumed \$53,202 in premiums and paid \$32,988 in claims under the terms of these agreements.

The Company failed to disclose any reinsurance agreements and transactions in its original 2006 Annual Statement filing. At the request of the CDI, the Company amended its 2006 Annual Statement and included disclosures of reinsurance transactions in Schedule S as well as other schedules and/or exhibits, as applicable. It is recommended that the Company fully disclose any reinsurance agreements and transactions in effect.

Ceded

The Company does not cede any reinsurance.

ACCOUNTS AND RECORDS

It was noted during the examination that the Company does not have adequate controls over the financial closing and reporting process to allow for accurate preparation of the statutory Annual Statement. As a result of these control weaknesses, the Company consistently made amendments to its Annual Statement. The December 31, 2006 financial statements included in this examination report reflect the amended amounts. It is recommended that the Company implement controls to detect errors and properly review its statutory financial statements before they are submitted to the California Department of Insurance.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2006

Summary of Operations and Capital and Surplus Account
for the Year Ended December 31, 2006

Reconciliation of Capital and Surplus
from December 31, 2002 through December 31, 2006

Statement of Financial Condition
as of December 31, 2006

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 12,016,638	\$	\$ 12,016,638	
Cash and short-term investments	8,062,482		8,062,482	(1)
Investment income due and accrued	223,738		223,738	
Accident and health premiums due and accrued	2,521,399		2,521,399	
Net deferred tax asset	314,041	158,507	155,534	
Receivables from parent, subsidiaries and affiliates	2,740,036	2,740,036		(2)
Health care and other amounts receivable	7,421		7,421	
Aggregate write-ins for other than invested assets	<u>2,173,033</u>	<u>2,173,033</u>	<u></u>	
Total assets	<u>\$ 28,058,788</u>	<u>\$ 5,071,576</u>	<u>\$ 22,987,212</u>	
<u>Liabilities, Surplus and Other Funds</u>				
Contract claims: Accident and health			\$ 5,295,000	(3)
Premiums and annuity considerations received in advance			687,631	
Commissions to agents due or accrued			485,975	
General expenses due or accrued			763,931	(1)
Taxes, licenses and fees due or accrued			397,663	
Asset valuation reserve			<u>54,093</u>	
Total liabilities			7,684,293	
Common capital stock		\$ 2,875,000		
Gross paid-in and contributed surplus		12,170,013		
Unassigned surplus		<u>(257,906)</u>		
Capital and surplus			<u>15,302,919</u>	
Total liabilities, surplus and other funds			<u>\$ 22,987,212</u>	

Summary of Operations and Capital and Surplus Account
for the Year Ended December 31, 2006

Statement of Income

Premiums and annuity considerations	\$ 74,772,493	
Net investment income	553,074	
Aggregate write-ins for miscellaneous income	<u>370,000</u>	
Total		\$ 75,695,567
Disability benefits and benefits under accident and health contracts	59,383,679	
Commissions on premiums, annuity considerations and deposit type contract funds	5,461,909	
General insurance expenses	7,006,226	
Insurance taxes, licenses and fees, excluding federal income taxes	<u>1,850,256</u>	
Total		<u>73,702,070</u>
Net gain from operations before federal income taxes		1,993,497
Federal income taxes incurred		<u>571,612</u>
Net gain from operations after federal income taxes		1,421,885
Net realized capital losses		<u>(3,773)</u>
Net income		<u>\$ 1,418,112</u>

Capital and Surplus Account

Capital and surplus, December 31, 2005		\$ 16,205,961
Net income	\$ 1,418,112	
Change in net deferred income tax	36,658	
Change in non-admitted assets and related items	(2,355,594)	
Change in asset valuation reserve	<u>(2,217)</u>	
Net change in capital and surplus for the year		<u>(903,042)</u>
Capital and surplus, December 31, 2006		<u>\$ 15,302,919</u>

Reconciliation of Capital and Surplus
from December 31, 2002 through December 31, 2006

Capital and surplus, December 31, 2002, per Examination			\$ 6,275,345
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income	\$ 4,042,041	\$	
Change in net deferred income tax	267,199		
Change in nonadmitted assets and related items	3,145,128		
Change in asset valuation reserve		26,794	
Surplus adjustment: Paid in	<u>1,600,000</u>	<u> </u>	
Total gains and losses in surplus	<u>\$ 9,054,368</u>	<u>\$ 26,794</u>	
Increase in capital and surplus			<u>9,027,574</u>
Capital and surplus, December 31, 2006, per Examination			<u>\$ 15,302,919</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Cash and Short-Term Investments General Expenses Due or Accrued

The Company has not filed unclaimed property returns. However, the Company accrues for unclaimed property in its General Expenses Due and Accrued account and plans to submit its first filing in 2007. It is recommended that the Company establish and implement written escheat procedures, transfer stale checks to an escheatable account, and escheat unclaimed property to the State of California Controller's Office as required by the California Unclaimed Property Act.

(2) Receivable from Parent, Subsidiaries and Affiliates

Prior to filing an amended December 31, 2006 Annual Statement, the Company reported a nonadmitted receivable balance of \$5.7 million which represents cash advances or transfers from the Company to the parent and were transacted without notice to or approval by the California Department of Insurance (CDI), pursuant to California Insurance Code (CIC) Section 1215.5(b)(1)(B). In conjunction with this transaction, the Company also reported a 75% reduction in management fees charged by its parent and affiliates. The Company treated the cash advance as reimbursement to the parent for 75% of the management fees that were actually incurred but not charged to the Company. However, there was no actual reduction in fees since the 75% was merely reported as a cash advance instead of as an expense.

On August 17, 2007, per the CDI's instruction, the Company amended and refiled its December 31, 2006 Annual Statement to reflect the significantly higher expenses and the corresponding reduction in the nonadmitted receivable balance from \$5.7 million to \$2.7 million. Pursuant to CIC Section 924, the Company was assessed and paid the late filing fees in July 2007. The Company settled the receivable balance in June 2007.

Based on these findings, it is recommended that the Company comply with CIC Section 1215.5(b)(1)(B) and timely settle intercompany balances.

(3) Contract Claims: Accident and Health

The Company's accident and health reserves were evaluated by a life actuary from the California Department of Insurance. Based upon the evaluation, the reserves for accident and health policies were determined to be adequate.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Management and Control – Management Agreements (Page 4): It is recommended that the Company submit all unapproved affiliated agreements to the California Department of Insurance (CDI) for approval pursuant to California Insurance Code (CIC) Section 1215.5(b)(4).

Corporate Records (Page 6): It is recommended that the Company implement procedures to ensure future compliance with CIC Sections 735. It is also recommended that the Company implement procedures to ensure that the authorization and approval of investments is documented in its board minutes to comply with CIC Sections 1200 and 1201.

Reinsurance – Assumed (Page 8): It is recommended that the Company fully disclose any reinsurance agreements and transactions in effect.

Accounts and Records (Page 9): It is recommended that the Company implement controls to detect errors and properly review its statutory financial statements before they are submitted to the CDI.

Cash (Page 14): It is recommended that the Company establish and implement written escheat procedures, transfer stale checks to an escheatable account, and escheat unclaimed property to the State of California Controller's Office as required by the California Unclaimed Property Act.

Receivable from Parent, Subsidiaries and Affiliates (Page 14): It is recommended that the Company comply with CIC Section 1215.5(b)(1)(B) and timely settle intercompany balances.

Previous Report of Examination

Management and Control - Holding Company Transactions (Page 5): It was recommended that the Company comply with California Insurance Code (CIC) Section 1215 requiring reporting and prior notice of certain affiliated transactions. It was also recommended that the Company implement its management service agreement in accordance with the terms of the agreement. The Company has not complied with these recommendations.

Corporate Records (Page 5): It was recommended that the Company implement procedures in its board meetings to ensure compliance with CIC Sections 735. It was also recommended that the Company comply with CIC sections 1200 and 1201. The Company has not complied with these recommendations.

Accounts and Records (Page 9): It was recommended that the Company comply with CIC Sections 1100, 1195, 1196 and 1215. It was also recommended that the Company establish and implement procedures and quality control tests to ensure that all information contained in its premium recording process is accurate. The Company has not complied with these recommendations.

Bonds (Page 12): It was recommended that the Company submit its custodial agreement to the California Department of Insurance (CDI) for approval. The Company has complied by transferring its securities to City National Bank, an approved custodian.

Cash (Page 12): It was recommended that the Company establish a procedure to transfer stale dated checks to an escheatable account. The Company has not complied with this recommendation.

ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/
Deanna Lo, CFE
Examiner-In-Charge
Senior Insurance Examiner
Department of Insurance
State of California